

Internal Revenue Service
memorandum

CC:TL:TS/P
ESHATZ/trs

date: **NOV , 5 1980**

to: District Counsel, Portland
Attn: Shirley Francis

from: Acting Branch Chief
Tax Shelter/Partnerships Branch CC:TL:TSP

subject: Section 6673 and TEFRA
TL-N-8840-90 9232-90
Shatz Wilson Portland
I.R.C. § 6673

This is in response to your request for tax litigation advice regarding the applicability of the I.R.C. § 6673 penalty to TEFRA partnerships and subchapter S corporations. You have specifically asked that we review a proposed response to Portland Appeals. While we agree with the conclusions reached in the response, we suggest that the following additional information be incorporated in your response.

ISSUE

Whether the section 6673 penalty is applicable to a TEFRA proceeding?

CONCLUSION

The section 6673 penalty is applicable in a TEFRA proceeding. Liability for the penalty requires a factual determination as to the culpability of each of the partners. In a typical case, however, it is the participating partners under Tax Court Rule 247(b) whose conduct will expose them to the section 6673 penalty.

ANALYSIS

Section 6673(a)(1) provides that the Tax Court may penalize a taxpayer up to \$25,000 for misusing the Tax Court proceedings by, for example, instituting or maintaining a proceeding for delay or to assert a frivolous position. It is clear from the statute that the section 6673(a) penalty is imposed by the Tax

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Court for actions of taxpayers in connection with Tax Court proceedings. Thus, the penalty is not a partnership item the treatment of which is governed by the TEFRA unified audit and litigation procedures of I.R.C. sections 6221-6233. Nor is it an "affected item" under section 6231(a)(5) because the application of section 6673 is not dependent on, or affected by, the treatment of a partnership item. Rather, the penalty is dependent solely on whether any action of the taxpayer led to the misuse of the Tax Court proceeding.

Generally, the Tax Court is reluctant to impose the section 6673 penalty absent a showing of culpability.^{1/} Therefore, judgment is required in determining which cases are appropriate for requesting the Tax Court to impose the penalty. For purposes of the following discussion, we will assume that the facts support the application of the penalty.

Historically, the section 6673 penalty has been applied to individual taxpayers as a result of their misconduct concerning a proceeding in which they were responsible for filing the petition and over which they had control. Because the effect of the TEFRA provisions is to create a uniform proceeding which will dispose of issues at the entity level rather than at the partner level, at first glance application of the penalty to conduct occurring in a TEFRA partnership level proceedings appears problematic. For example, it may be difficult to assign culpability in cases in which the tax matters partner files a frivolous petition on behalf of all the partners. However, a careful reading of the statutory language supports the conclusion that despite the additional layer of complexity imposed by TEFRA, the section 6673 penalty should be imposed in TEFRA cases when appropriate.

The TEFRA provisions and the Tax Court rules contemplate that partners will retain a degree of control over the institution and conduct of the partnership proceeding. Under sections 6226(a) and (b) and Tax Court Rule 241, it is not the partnership, but the partner filing the petition in the Tax Court, who is the petitioner. 1983 Western Reserve Oil and Gas Company v. Commissioner, 95 T.C. No. 4 (July 12, 1990) (Slip Op.

^{1/} Generally, cases which warrant a claim for damages on the grounds that the proceeding was instituted or maintained primarily for delay or that the taxpayer's position is frivolous or groundless involve a showing that:

1. there are no bona fide issues to be decided by the court;
2. the taxpayer knew or should have known that his or her arguments were wholly without merit; and
3. the taxpayer's conduct in the proceeding, or in the administrative stages prior to institution of the proceeding, involves an element of culpability.

at 12). Tax Court Rules 245 and 247 permit partners to file a notice of election to participate in the proceeding. Even partners who do not elect to participate are treated as parties to the partnership proceeding under section 6226(c) if they have an interest in the outcome of the proceeding. Having provided partners an opportunity to have an impact on the course of the litigation, the Code and the Tax Court rules also support the conclusion that partners, as parties to the litigation, are responsible for their actions which violate section 6673.

The degree to which a partner will be liable for the section 6673 penalty in a TEFRA proceeding is a factual determination. If a petition is filed by a partner and that petition is frivolous, then clearly that partner is liable for the penalty in his capacity as a partner. Participating partners who elect to participate or intervene in such a proceeding may also be liable based on the statutory language which prohibits the maintenance of frivolous suits. Although in most instances participating partners will play a more active role in the conduct of the litigation than nonparticipating partners and therefore are more likely to be liable for the section 6673 penalty, nonparticipating partners are parties to the proceeding pursuant to section 6226(c) and Tax Court Rule 247(a). Thus, if the facts warrant, nonparticipating partners may also be held liable under section 6673. An example of such a case may be where a group of partners form a defense fund to fund litigation by one of their members for purposes of delay. Although only one member of the group might be a participating partner, the facts and circumstances may justify imposing the section 6673 penalty against the nonparticipating partners whose actions led to the misuse of the Tax Court proceeding. Indemnification or similar arrangements between the partners which attempt to shift the ultimate liability for payment of the penalty to other partners should be irrelevant for purposes of determining culpability under section 6673.

Please refer any questions regarding this matter to Eileen Shatz at FTS 566-4369.


CURTIS G. WILSON